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Task Force on Financial Literacy
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Subject: FAIR Canada's Submission to the Task Force on Financial Literacy's "Leveraging Excellence" Consultation Document

FAIR Canada Congratulates the Minister of Finance and the Task Force

FAIR Canada would like to begin this submission by congratulating the Federal government and, in particular, Minister Jim Flaherty for establishing the Task Force. We would also like to congratulate the Task Force on the Consultation Document it has produced, as well as the national consultation process that it is undertaking. The dedication and attention of the Federal Minister of Finance and of Task Force members to this project are crucial steps to establishing a strategy on financial literacy that will not only improve Canadians' knowledge, but will improve the financial security and prosperity of Canada as a whole.

FAIR Canada was established as an organization to provide a national voice for investors and to enhance the rights of investors and shareholders in this country. We are a national, non-profit agency, independent of government, regulators and the financial industry, focused on advancing the rights of Canadian individual investors and shareholders. Providing a timely response to securities regulatory and related initiatives such as the Task Force's Consultation Document is a key element of FAIR Canada's mandate. On the topic of financial literacy, FAIR Canada published a *Financial Literacy Back to School Newsletter* in October 2009.[1]

We believe in certain core principles within the investment industry and capital markets as being key to the well-being of Canadian investors as a whole: integrity, fairness, trust, transparency and accountability. Financial literacy and its promotion are key building blocks in this strategy. Without a solid base of financial literacy, investors are unable to properly make decisions to manage and protect their finances and investments and therefore to secure their financial futures.

1 See http://faircanada.ca/top-news/financial-literacy-back-to-school-newsletter/ for a copy of the newsletter.

The Aim of a Financial Literacy Strategy

Canadians are participating more than ever before in the financial markets, and are increasingly reliant on financial markets for their financial security. They are forced to do so by changes in the market and government policy, such as the rapid decline in defined benefit pension plans and the rise of self-administered pensions. But financial literacy has not kept up with the shift in responsibility to individual Canadians. This has been compounded by the increasing complexity of financial products and markets. The absence of a priority within school systems generally (at all levels) to promote financial literacy has, we feel, been key to the lag in financial literacy standards.

Canadians have been increasingly relying on the financial industry to advise them and on securities regulators to protect them when things go wrong. They have been disappointed. The numerous financial frauds and scandals of recent years have cost investors uncounted millions, and uncounted millions more have disappeared in unsuitable investments and the high fees charged by the Canadian investment industry.

FAIR Canada believes that Canadian governments should work together, through a permanent institutional structure, to develop and implement a national financial literacy strategy. We recommend the following action plan:

1. *Creating* and *funding* a permanent institutional structure through which a national Financial Literacy Strategy (also referred to as the "Strategy") can be coordinated and implemented. Without a stable funding commitment from different levels of government, no strategy can be properly implemented, and the efficacy of such a strategy cannot be monitored. With a permanent institution, governments, regulators and educators have a permanent resource that can coordinate the Strategy and provide a long-term base from which to create future initiatives. This requires clear and committed political leadership at all levels of government.

2. *Mandatory* financial literacy education in all Canadian high schools to allow the next generation of Canadian workers and investors to participate in financial markets with a basic level of financial literacy.

3. *Testing* by government bodies (including both regulators and educators) of the effectiveness of current and future adult financial literacy initiatives.

4. *Encouraging* a long-term shift of responsibility from consumers to the financially sophisticated market participants who manufacture and sell financial products. This encompasses not only responsibility for failures in the financial markets, but crucially the responsibility to educate and inform investors about products and the application of financial literacy to real-life financial and investment issues.

5. *Leveraging* existing public resources, and encouraging regulation, to create a better "architecture of choice" for investors. In these ever increasing complex financial decisions, we must make it easier for consumers to make wise financial choices.

6. *Deploying* the Financial Literacy Strategy and the tools and education developed through adaption to new technology and new methods of communication.

7. *Opposing,* directly and forcefully, misinformation, pressure tactics, and institutional barriers to financial literacy and good financial decision-making that are frequently adopted by the financial industry. Regulation of financial marketing and advertising must require that both risks and benefits be presented in a fair and balanced way to investors.

The Role of the Task Force

We believe that the Task Force can best accomplish its mandate through recommending to the Minister of Finance a comprehensive strategy that is backed by a *permanent* institution that will implement the strategy and serve as a central pivot through which both the public and private sectors, and all departments and bodies of both the federal and provincial governments (including schools), can coordinate their action to support and foster financial literacy.

We believe that, without a stable, funded institution to implement the strategy, adoption of the Task Force's recommendations will be spotty at best, constrained by problems of co-ordination, inadequate funding, and a lack of information-sharing among all interested parties.

We consider the goals of a Financial Literacy Strategy to be fairly clear, and also (crucially) measurable. The goal is not merely to improve baseline scores on tests of financial literacy concepts, but to result in improvements to debt levels, savings rates, and reductions in financial fraud losses.

Financial Literacy

If we take as a given the Task Force's definition in "Leveraging Excellence" of financial literacy as meaning that investors should have “the knowledge, skills and confidence to make responsible financial decisions," then there are certain crucial points that need to be considered within the Strategy:

- Financial literacy must be *progressively* measured and must be appropriate for the challenges faced by particular individuals. Although there is a certain minimum level of financial literacy (that could, for example, be addressed through the school system), as investment challenges increase, there must be a corresponding increase in understanding by investors and consumers.

- Financial literacy itself must build off skills of literacy and numeracy, in which Canadians already face their own challenges.

- Basic concepts of financial literacy like budgeting, savings, and debt management must be at the forefront of a basic financial literacy strategy. It is also important to teach investors about how to avoid investment scams and frauds, by adopting a sceptical attitude to investments that “look too good to be true” and becoming well-informed by asking questions before making investment decisions. [2]

- "Responsible financial decisions" do not occur within a vacuum but occur within the financial marketplace. These decisions can be made clearer and easier by encouraging standards of clarity and transparency within the financial industry, as well as encouraging (via legislative

[2] FAIR Canada is an active member of the FADOQ Anti-Abuse and Fraud Task Force, and has published an article in the FADOQ magazine *Virage* describing anti-fraud warning signs and tips for investors.

action or otherwise) the creation of better-designed products, the leveraging of existing public management resources, and an improvement in the enforcement of securities laws.

The Backdrop

The Task Force must always remain aware that its work, and the Financial Literacy Strategy, are taking shape against a backdrop where the savings and investment challenges faced by Canadians have never been greater. A rapidly shrinking portion of the Canadian labour force belongs to a workplace pension plan, and few of those have access to defined benefit plans, making the need for informed decision-making about retirement investing greater than ever. There is certainly no intimation that this will change; fewer employers offer defined benefit pension plans, younger people are changing jobs more often, and access to workplace pensions is correspondingly limited.

Leadership

Any recommendations created by the Task Force will require leadership at the highest level - including the Prime Minister, the Federal Finance Minister and the Premiers - to be implemented effectively. Leadership here means more than simply striking the Task Force - it means listening to its recommendations and then committing resources to ensure that those recommendations are put into practice. Canada is playing "catch-up" with the rest of the world, but we believe that the Financial Literacy Strategy, properly implemented, will play an important role in putting Canada at the forefront.

The FAIR Canada Action Plan

As described above, the FAIR Canada Action Plan consists of seven distinct areas of emphasis for the Financial Literacy Strategy. The Action Plan will allow the Strategy to make a real, lasting impact on the financial well-being of all Canadians:

1. **Creating and funding a permanent institutional structure through which a national Financial Literacy Strategy can be coordinated and implemented.**

2. **Implementing mandatory basic financial literacy education at the high school level.**

3. **Testing and obtaining feedback of financial literacy initiatives.**

4. **Encouraging a shift of responsibility for educating and informing investors to the financial industry, through persuasion and regulation.**

5. **Leveraging existing public resources, and encouraging regulation, to create a better "architecture of choice" for investors.**

6. **Adopting new technology and media early, to deploy financial literacy education.**

7. **Opposing misinformation and pressure tactics from the financial industry.**

1. A Permanent Institutional Structure

FAIR Canada believes that creating and funding a permanent, national institutional structure through which the Financial Literacy Strategy can be coordinated and implemented is crucial to the success of the Task Force's mandate.

- Without an institutional body that has a stable funding commitment from government, the Strategy will be quickly lost in the shuffle of "more pressing priorities".
- An institutional body, on the other hand, is able to press both governments and the private sector for action on the Strategy and the Task Force's recommendations.
- An institutional body can monitor compliance and effectiveness.
- An institutional body can become a permanent center for the coordination of activities among the public and private sectors, between provinces and the federal government, and even among the disparate boards and ministries and bodies of particular governments. The Financial Literacy Strategy will undoubtedly demand action across various government departments.
- An institutional body provides a stable base from which future initiatives can be created. The task of creating a Financial Literacy Strategy is not enough; such a Strategy must be maintained and kept up-to-date with a changing world, long after the Task Force itself has delivered its report.

A National Structure

In order to be successful, an institution must be national in scope, have direct accountability to the Federal Minister of Finance, but simultaneously maintain a strong relationship with the provinces.

A Permanent Structure

Without a permanent, long-term mandate, any effort at coordination may create short-term gains but will lack the ability to effectively negotiate with the private sector for real gains, and cannot make long-term plans to effectively benefit younger Canadians, whose financial interests are most affected by the high and rising levels of financial illiteracy and the discrepancy between financial literacy and the increasing sophistication and complexity of the financial markets and products.

A Funded Structure

Although an institutional structure could well look to the private sector and the financial industry for support, certain key elements of an effective Financial Literacy Strategy (as will be discussed below) must necessarily be antagonistic, in certain respects, to the interest of that industry in order to fully protect Canadian consumers. As such, stable funding from government is needed in order for the Strategy to be effectively implemented.

Something Old, Something New?

FAIR Canada does not recommend any particular institutional structure for carrying out the Financial Literacy Strategy beyond the above recommendations. It could be that an existing body such as the Financial Consumer Agency of Canada be strengthened, financially supported, and given a mandate of implementing the Strategy. It could be that a specialized body or organization be created under the authority of the Minister of Finance to undertake the implementation of the Strategy. Or it could be that a quasi, non-governmental organization be established, with Board representation from both federal and provincial governments, to carry out the implementation of the Strategy.

The key is, we feel, to ensure that *someone* be given a *specific* mandate to further the Financial Literacy Strategy without competing pressures, together with the necessary power to implement the Strategy. The institution must also report to and be championed by a senior political leader, such as the Federal Minister of Finance.

2. Testing and Feedback

The commitment of public money and resources should, in our view, be allocated based on firm, objective and testable targets. The use of tools such as the Canadian Financial Capability Survey by Statistics Canada could establish a baseline case of where we stand, nationally and regionally, across different demographic and economic groups, and this survey should be supplemented with additional in-depth surveys on particular areas of concern. There should also be follow-ups with regular surveys every other year to monitor progress and to uncover particular areas of weakness.

3. Mandatory Basic Financial Literacy Education in High Schools

One specific recommendation that FAIR Canada would make is to encourage Boards and Ministries of Education across Canada to adopt mandatory basic financial literacy education at the high school level.

For example, part of British Columbia's mandatory *Planning 10* high school course is a segment on finances and financial literacy, devoted to basic financial life skills and directed at Grade 10 students. Patricia Bowles, the Director of Communications and Education at the British Columbia Securities Commission, has reported that in the eight years since the adoption of the financial skills course in Planning 10, degrees of improvement in students' post-high school money-management skills have been observed.

As discussed above, due to the changing financial landscape of Canada, with increased access to debt and a changed job market necessitating higher levels of personally-managed savings than ever before, the impact of financial literacy deficits will be felt disproportionately by young people. It is therefore crucial for the Financial Literacy Strategy to encourage reasonable, achievable goals in promoting financial literacy among the young. B.C.'s example shows that mandatory segments in high school are possible and effective.

A permanent institution for implementing the Financial Literacy Strategy could serve as a clearinghouse for such programs, encouraging information and curricula transfers and providing a resource to help cross-country teacher training in association with provincial Ministries of Education.

4. Encouraging a Long-Term Shift of Responsibility: Aligning Financial Industry Interests with Financial Literacy Goals

As discussed above, a Financial Literacy Strategy should aim at certain measurable, objective goals, such as reduced levels of consumer debt and debt-to-income ratio; increased levels of consumer savings; increased levels of financial plan-making and retirement planning; increased take-up of tax-efficient retirement savings; reduced spending on fees relative to savings; and reduced levels of financial fraud losses.

Such a strategic goal may be and often will be diametrically opposed to the short-term interests of the financial industry. Reducing consumer debt levels may directly impact the profit available to the financial industry. Reducing fees or a shift by investors to lower fee products will similarly have a direct impact on industry profits.

FAIR Canada believes that a key component of a national Financial Literacy Strategy must be to help drive a long-term alignment of the interests of the financial industry as a whole with the interests of the consumers of that industry and those persons' long-term financial well-being. This demands not merely goodwill or good works on behalf of the financial industry; it requires regulators and governments to help put in place the incentives necessary to create that alignment of interests. In the short term, the financial industry's hands are tied by its responsibility to maximize shareholder profits, profits that can only be wrung from the pockets of its customers - the investing and borrowing public at large.

However, sensible regulation of sectors such as consumer credit can have the effect, over the long term, of boosting the alignment of the interests of the financial industry and the interests of its clients - and that will serve as a significant boost to the industry's interest in promoting financial literacy. Credit card lending is a key example. Under an extremely common current model, high interest credit card rates boost short-term profits and high credit-card and consumer debt usage boost short-term profits as well, generally at the expense of those consumers who can least afford to pay interest rates of 20% or more. This encourages an unhealthy and unsustainable level of consumer debt. The widespread availability of unsecured credit card debt encourages many to live beyond their means, creating a financial time bomb for many Canadians.

Regulation to tighten the availability of consumer credit-card debt and to reduce the interest rates that can be charged on such debt, would have the effect of aligning the long-term interests of financial industry participants with customers.

Regulations to tighten the availability of leveraged investments through securities firms could have a similar effect. The need for lower rates of default in such an environment could act as an increased incentive for financial industry participants to promote financial literacy and sustainable financial management.

Similarly, some studies have shown that Canadian investors are burdened with the highest mutual fund fees in the world (see the 2007 study by Khorana, Servaes and Trufano which found that in every segment studied, Canada's mutual fund fees were the highest of the 18 countries studied). The strong marketing and advertising by the financial industry often influences Canadians to purchase mutual funds for their retirement needs, and amongst itself the industry is competitive. But there has been no resultant downward pressure on the fees charged to consumers. Educating Canadian investors about the real effect of fees on total investor returns is difficult enough - against the cacophony of advertising from financial industry participants, it becomes impossible. Sensible regulation to tighten fee structures, foster low-fee alternatives and encourage fees to track performance (aligning, again, the interests of the industry and its clients) would not only provide real alternatives, it would encourage the industry to train its clients in financial literacy, including about the importance of saving and investing in lower fee products - on the basis of *principles* rather than *products*.

A permanent institution tasked with the implementation of the Financial Literacy Strategy would be able to lobby and encourage governments and regulators to take the steps necessary not only to promote financial literacy but also to promote the overarching goals of financial literacy education and of the Task Force itself: reducing debt levels, increasing savings rates, encouraging sustainable financial planning, and reducing the significant impact of high fees on investor savings.

5. Increasing Public Choice by Leveraging of Public Management Resources

One of the key goals of the Task Force needs to be to help restructure the "architecture of choice"[3] that Canadians face in planning their retirement investments. Currently, a competitive retail investment management industry provides a panoply of choice for investors, but it does so at considerable cost to investors (as described above). Meanwhile, some of Canada's strongest-performing investment managers are locked away advising pension plans such as the Canada Pension Plan.

FAIR Canada encourages the Task Force to make a positive recommendation to require the Canada Pension Plan[4] (the CPP), and allow all other large pension plans, to offer Canadians the choice to make RRSP contributions into private accounts, to be pooled into a fund managed by such pension plans.[5] In turn, such accountholders could be permitted to take advantage of additional financial literacy resources that such a program could make available. We consider that no other proposal could so radically increase the practical public choice available to Canadians regarding their retirement savings. The size and power of such funds would make them extremely attractive as a "default choice" for Canadians concerned with accessing good economic performance, in safe hands, with a simple and easy-to-understand product, and at low cost. This in turn would, we consider, "nudge" the private for-profit financial industry towards providing services that would improve the architecture of choice for retirement savers.

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[3] We borrow the concept of the "architecture of choice" from *Nudge* by Richard Thaler and Cass Sunstein, which describes an architecture of choice as a designed environment in which people make decisions. Wherever there is a human-created or human-affected environment in which people make decisions - in this case savings and investment decisions - care should be taken to consider the impact of the architecture on people who make choices in that environment. Because people are susceptible to certain biases and assumptions that can lead them to making detrimental choices, well-crafted public policy can seek to improve the architecture of choice and promote beneficial choice without harming the freedom to choose. One of Thaler and Sunstein's key recommendations is to make choosing *easy*; "making life as easy as possible" can and should be a key goal in designing such architectures.

[4] We suggest that the CPP be required to offer Canadians this option since most Canadians already contribute to, and will benefit from, the CPP.

[5] In this context, FAIR Canada agrees with the recommendation noted in the widely circulated April 2010 *Ambachtsheer Letter* to create a national supplementary pension plan.

Retirement savings is not the only area where a permanent institution implementing the Financial Literacy Strategy could work to "nudge" the financial industry towards providing a better architecture of choice. Such a body could encourage the adoption (voluntarily or through regulation) of improved disclosure regarding consumer borrowing - from mortgages to credit cards - including clear standards for advertising and marketing.

A more ambitious plan would be to leverage the existence of the permanent institution we are advocating as part of the Financial Literacy Strategy, to encourage the development of an independent body to provide low-cost, not-for-profit financial planning that is independent of all financial industry participants. This could be provided on a legal-aid type model or potentially, through a national centre for financial advice that would leverage the use of modern technology (including the World Wide Web, videoconference capability, and increased access to online financial tools and data tracking) to help reduce costs. It would be possible even now for most Canadians, especially younger Canadians, to provide a financial advisor working anywhere in Canada with a complete and accurate picture (and data trail) of their income, expenses, and investment accounts via the web, and to sit down and discuss financial planning with them, secure in the knowledge that their advisor has a complete understanding of their financial situation.

Furthermore, as described above, the very existence of such a source of objective financial advice would necessarily pull other financial advisors (whether connected to financial institutions or brokerages, or fee-only advisors) towards providing a more objective assessment, and would encourage *process*-oriented planning over *product*-oriented planning.

6. Deploying the Strategy and Financial Literacy Education and Tools through New Media

We have discussed above the possibility of using new media and new technology both to promote the Financial Literacy Strategy itself and more importantly, the education and tools that will be fostered by the Strategy to meet the financial literacy needs of Canadians. This touches not only on communications channels such as interactive and social media (such as Facebook, Twitter, or YouTube) but also the increased deployment of communications technology and how it can affect patterns of spending, saving, and borrowing. The growth in communications technology will make spending and borrowing easier than ever before - a Financial Literacy Strategy that does not take this into account will not be flexible enough to meet the needs of younger people perfectly comfortable with modern technology and a cashless society.

Furthermore, as discussed above in connection with financial planning, the challenges of encouraging responsible, sustainable financial management can be met through technology as well. Just as it is possible to make on-the-spot purchases through a smartphone, a comprehensive Financial Literacy Strategy will see to it that technologies that allow your smartphone to do on-the-spot and up-to-the-minute budgeting, or cost-of-borrowing comparisons, are developed and fostered.

A permanent institution could become the hub for a major internet presence (with a seamless mobile interface) deploying state-of-the-art tools for financial management - right at the place where the rubber of financial literacy meets the road of life. Promotion - especially to younger people at a critical stage in their fiscal development - is of paramount importance.

Finally, the World Wide Web can be a tremendous tool in making large amounts of material available inexpensively, including specific information related to the major life decisions when financial literacy questions (and interest in the topic) can be engaged.

7. Opposing Misinformation

Finally, FAIR Canada recommends that the national Financial Literacy Strategy strenuously oppose misinformation or misleading information within the financial industry. Clearly, this is most important in the case of fraud and other illegal activity, but it applies equally to the puffery of even our most august financial institutions regarding the products they provide.

A Financial Literacy Strategy, unfortunately, cannot work effectively if it does not address the need to make Canadians more suspicious and less trusting of financial advertising and promotions. It cannot work effectively unless it takes a hard line at combating the advertising and marketing practices of a highly competitive industry with a pervasive advertising and promotional presence. In this, even a permanent institution charged with implementing a Financial Literacy Strategy will be a David fighting an industry Goliath, but it will at least be a foundation for an *effective* strategy in a world where, at present, most Canadians rely on someone else's advice for making important financial decisions.

Conclusion

FAIR Canada would like to encourage further dialogue with the Task Force and with other commentators on the "Leveraging Excellence" consultation document, on the issues we have raised and on other issues arising from the consultation, and would like to extend our sincere appreciation to the Task Force for the opportunity to provide these comments. We look forward to presenting our remarks at the Task Force's public session in Ottawa on May 12, 2010. In the meantime, feel free to contact us with any questions or comments regarding this document at the coordinates listed below.

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